



GOVERNOR'S OFFICE OF  
BUDGET AND PROGRAM PLANNING

## Fiscal Note 2017 Biennium

<b>Bill #</b>	HB0511	<b>Title:</b>	Provide tax credits for contributions to scholarship organizations
<b>Primary Sponsor:</b>	Tschida, Brad	<b>Status:</b>	As Introduced

- |   |   |  |
|---|---|--|
| <input type="checkbox"/> Significant Local Gov Impact     | <input checked="" type="checkbox"/> Needs to be included in HB 2  | <input checked="" type="checkbox"/> Technical Concerns   |
| <input type="checkbox"/> Included in the Executive Budget | <input checked="" type="checkbox"/> Significant Long-Term Impacts | <input type="checkbox"/> Dedicated Revenue Form Attached |

### FISCAL SUMMARY

	<u>FY 2016 Difference</u>	<u>FY 2017 Difference</u>	<u>FY 2018 Difference</u>	<u>FY 2019 Difference</u>
<b>Expenditures:</b>				
General Fund	\$605,672	(\$362,792)	(\$1,054,600)	(\$1,696,287)
<b>Revenue:</b>				
General Fund	(\$6,383,000)	(\$7,881,000)	(\$9,812,000)	(\$12,304,000)
<b>Net Impact-General Fund Balance:</b>	<u>(\$6,988,672)</u>	<u>(\$7,518,208)</u>	<u>(\$8,757,400)</u>	<u>(\$10,607,713)</u>

**Description of fiscal impact:** This bill would create a tax credit for donations to organizations that would provide scholarships to private school students or provide grants to public schools for programs outside their existing curricula. This would reduce general fund revenue by \$6.4 million in FY 2016 with the revenue reduction increasing to \$12.3 million by FY 2019. Costs to administer the credit would be about \$170,000 per year, and one-time costs for systems programming to set up the new credits and related tracking systems required by this bill would be \$780,000.

### FISCAL ANALYSIS

#### Assumptions:

#### **Department of Revenue**

1. This bill would allow taxpayers to take a credit against individual or corporate income tax for donations to Student Scholarship Organizations (SSOs), which would give scholarships to students in private schools, and for donations to Education Improvement Organizations (EIOs), which would make grants to public schools for programs not included in their current curricula. Credits would be for 50% of the amount of the donation, but would be limited to 50% of the taxpayer's tax liability. The total amount of each credit would

- be limited to no more than \$5 million for the first year with the amount increasing by 30% each year. (See Technical Note 1.) Taxpayers would not be able take a charitable deduction for any amounts used to claim the credit. This bill would be effective beginning with TY 2015 and would terminate at the end of TY 2023.
2. Several states have credits for contributions to SSOs, but all have credit percentages that are different from the ones in this bill or are subject to limits on individual or total credits that are not equivalent to the limits in this bill. Pennsylvania appears to be the only state with a credit for contributions to EIOs as well as SSOs, but it is only available for corporations and is subject to a cap on total credits. While it is not possible to assume that donations and credits will be proportional to another state's, information from other states can be used to estimate what would happen in Montana. The following three facts from other states are used in this fiscal note: a) In Arizona, the number of individual donors to SSOs has consistently been about 1.35 times private school enrollment. The same ratio is assumed to hold in Montana. b) The Pennsylvania cap on total credits is the largest relative to the size of the state's economy, 0.0176% of state gross domestic product, and donations generally are at or near the cap. It is assumed that Montana corporations would be willing to donate at least this percentage of state gross domestic product. c) In Pennsylvania, 30% of corporate donations are designated for EIOs. This percentage is set in statute, but it is likely that if donors wanted significantly different proportion of their donations to go to EIOs, they would ask the Legislature to change it. Therefore, it is assumed that 70% of corporate donations would go to SSOs and 30% would go to EIOs.
  3. Under reasonable assumption about the average size of individual credits, credits for donations to SSOs will be at the cap through at least TY 2018. Credits will be claimed on tax returns filed the spring after each tax year. Most of the funds donated to SSOs by individuals would have gone directly to a school either as tuition or direct donations. Part of the funds corporations would donate to SSOs would have gone directly to schools as donations, part would have been donated to other charities, and part would be new donations. Since credits would be allocated to taxpayers in the order they applied, it is impossible to know what the mix would be. On average, about one-third of current private school budgets are supported by donations, so it is assumed that one-third of donations to SSOs would be funds that would have been donated to a charity and used as the basis of a charitable deduction. Credits and the offset due to reduced charitable deductions for FY 2016 through FY 2019 are shown in the following table. Individual donors are assumed to have marginal tax rates that are the same as the 6.75% corporate rate, on average. Credits for FY 2020 through FY 2024 and effects on enrollment are shown in the long-run impacts section.

Credits for Donations to SSOs (\$ million)	FY 2016	FY 2017	FY 2018	FY 2019
Credits	(\$5.000)	(\$6.500)	(\$8.450)	(\$10.985)
Charitable Deduction Offsets	\$0.225	\$0.293	\$0.380	\$0.494
<b>Net Effect</b>	<b>(\$4.775)</b>	<b>(\$6.208)</b>	<b>(\$8.070)</b>	<b>(\$10.491)</b>

4. Montana gross state product was \$44.040 billion in 2013. The average annual growth rate from 2010 to 2013 was 4.09%. It is assumed that gross state product will continue to grow at this rate. Corporate donations to EIOs are assumed to be 0.0176% of gross state product. No state has a credit for individual donations, so there is no direct basis for estimating credits in Montana. However, it is likely that individual donations to EIOs will be much less than corporate donations. Individuals who would donate out of an interest in a particular school or particular student are more likely to donate directly to a school or to an SSO. Individuals who donate to EIOs are likely to have relatively high incomes, to make regular donations to charities, for which they take an itemized deduction, and to decide to allocate part of their donations to an EIO rather than to another charity. For purposes of this fiscal note, individual donations are assumed to be one-third of corporate donations. Credits will be claimed on tax returns filed in the spring following each tax year. The following table shows the effects of corporate and individual credits and the reduction in individual and corporate deductions.

<b>Revenue Impact of Credits for Donations to EIOs (\$ million)</b>	<b>FY 2016</b>	<b>FY 2017</b>	<b>FY2018</b>	<b>FY 2019</b>
Corporate Credits	(\$1.263)	(\$1.314)	(\$1.368)	(\$1.424)
Individual Credits	(\$0.421)	(\$0.438)	(\$0.456)	(\$0.475)
Charitable Deduction Offsets	\$0.076	\$0.079	\$0.082	\$0.085
<b>Net Effect</b>	<b>(\$1.608)</b>	<b>(\$1.674)</b>	<b>(\$1.742)</b>	<b>(\$1.813)</b>

5. The Department of Revenue would need to develop four new forms for SSOs, EIOs, and taxpayers to report the new credits in this bill. The department also would need to have the new credits and associated forms added to its data processing systems. One-time costs would be \$432,118 in FY 2016. Two new FTE would be needed to handle the preapproval of credit applications, annual reports from SSOs and EIOs, and additional credit forms filed with donor's tax returns. Personal services costs would be \$154,188 in FY 2016 and FY 2017, \$156,846 in FY 2018, and \$159,556 in FY 2019. One-time costs to set up new employees would be \$6,596 in FY 2016. On-going operating costs would be \$12,770 in FY 2016, \$13,408 in FY 2017, \$13,610 in FY 2018, and \$13,814 in FY 2019.

#### Office of Public Instruction

6. Using the calculation required by HB 511, the per-pupil average of total public school expenditures was \$10,418 for the FY 2013-14 school year. The average was \$9,551 for elementary programs and \$11,272 for high school programs. The funds that must be included in the calculation of the per-pupil average include general fund; transportation; bus depreciation; food services; tuition; retirement; miscellaneous programs; traffic education; non-operating; lease rental agreement; compensated absence fund; metal mines tax reserve; state mining impact; impact aid; litigation reserve; technology acquisition; flexibility fund; debt service; building reserve; and inter-local agreement.
7. In FY 2016, 257 students are projected to transfer from public school to a private school. This will result in a decrease of 267 current year ANB in FY 2016. State support per ANB for K-12 BASE Aid is approximately \$4,518. The chart below shows the estimated impact for years FY 2016 - FY 2019 (see local impact assumption #11).
8. School districts budget on the higher budget calculated using the prior year ANB numbers or the average of the prior three years' ANB whichever creates the highest budget limits. The reduction of enrollment due to the benefits of HB 511 would not be recognized in state K-12 school funding until FY 2017. Assuming the reduction of students and three-year averaging of ANB, the following table represents the proposed phase-in of reduction to state funding due to movement of public school students to private schools attributed to HB 511.

<b>Fiscal Year</b>	<b>Enrollment</b>	<b>ANB</b>	<b>Change in K-12 state funding</b>
<b>FY 2016</b>	257	267	\$0
<b>FY 2017</b>	339	352	\$530,388
<b>FY 2018</b>	444	461	\$1,225,056
<b>FY 2019</b>	576	598	\$1,869,657

9. The transfer of these students from public schools is not expected to affect any other of the formula-driven sources of state funding for schools such as school facility reimbursements, transportation aid, or retirement GTB.

	<b><u>FY 2016 Difference</u></b>	<b><u>FY 2017 Difference</u></b>	<b><u>FY 2018 Difference</u></b>	<b><u>FY 2019 Difference</u></b>
<b><u>Fiscal Impact:</u></b>				
<b>FTE (DOR)</b>	2.00	2.00	2.00	2.00
<b><u>Expenditures:</u></b>				
Personal Services (DOR)	\$154,188	\$154,188	\$156,846	\$159,556
Operating Expenses (DOR)	\$444,888	\$13,408	\$13,610	\$13,814
Equipment (DOR)	\$6,596	\$0	\$0	\$0
Local Assistance (OPI)	\$0	(\$530,388)	(\$1,225,056)	(\$1,869,657)
<b>TOTAL Expenditures</b>	<b>\$605,672</b>	<b>(\$362,792)</b>	<b>(\$1,054,600)</b>	<b>(\$1,696,287)</b>
<b><u>Funding of Expenditures:</u></b>				
General Fund (01)	\$605,672	(\$362,792)	(\$1,054,600)	(\$1,696,287)
<b>TOTAL Funding of Exp.</b>	<b>\$605,672</b>	<b>(\$362,792)</b>	<b>(\$1,054,600)</b>	<b>(\$1,696,287)</b>
<b><u>Revenues:</u></b>				
General Fund (01)	(\$6,383,000)	(\$7,881,000)	(\$9,812,000)	(\$12,304,000)
<b>TOTAL Revenues</b>	<b>(\$6,383,000)</b>	<b>(\$7,881,000)</b>	<b>(\$9,812,000)</b>	<b>(\$12,304,000)</b>

**Net Impact to Fund Balance (Revenue minus Funding of Expenditures):**

General Fund (01)	(\$6,988,672)	(\$7,518,208)	(\$8,757,400)	(\$10,607,713)
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**Effect on County or Other Local Revenues or Expenditures:**

1. Grants from EIOs to school districts are expected to be between 90% and 95% of donations. These grants must be for new programs that are not part of the district's normal curriculum. Districts will not be able to use grant funds to offset revenue from property taxes or other sources for existing school operations.

**Long-Term Impacts:****Department of Revenue**

1. This bill would remain in effect through TY 2023, so that credits would continue to be claimed through FY 2024.
2. This bill contains caps on total donations, individual donations, and average scholarships which could come into play at various points between 2015 and 2023. The aggregate limit on credits would increase by 30% each year, reaching \$40.8 million for TY 2023. Aggregate credits also could be limited by the cap on individual credits at 50% of tax liability. Total scholarships are limited by the requirement that the average scholarship not exceed 30% of the average cost per student in public schools. For 2014, this would be \$3,120. The maximum amount of scholarships that could be granted would be this amount times the number of private school students.
3. The availability of scholarships from SSOs would induce some students to switch from a public school to a private school. It also would cause some students to switch from home schooling to a private school. Existing and new private schools will be able to accommodate increased enrollment only if tuition paid by new students, plus new funding from donations to SSOs, is more than the cost of serving the additional students.
4. Most private schools charge tuition that is less than the school's expenses per student. The difference is made up from donations, subsidies from a church or other sponsoring organization, and other sources, such

as earnings on an endowment. Average tuition, as reported by the online private school directory privateschoolreview.com is \$6,818. Some students are offered discounts or currently receive scholarships, and average discounted tuition appears to be about \$6,000.

5. Private schools will expand enrollment only if they receive additional revenue to pay the costs of serving the additional students. Since this bill does not directly provide any funds to schools, the only way for them to expand enrollment is to increase tuition and use the additional revenue from existing students to subsidize additional students. Existing students would continue to enroll as long as the tuition increases were less than additional scholarship funding provided by SSOs.
6. Financial information on annual reports that tax-exempt private schools are required to file has been compiled in a report published by the University of Colorado and Arizona State University: Bruce Baker: Private Schooling in the U.S.: Expenditures, Supply, and Policy Implications. Boulder and Tempe: Education and the Public Interest Center, University of Colorado & Education Policy Research Unit, Arizona State University, 2009. Average costs per pupil vary between types of schools and range from about 30% lower to about 50% higher than per-pupil costs in public schools. Based on the mix of schools in Montana, average per-pupil costs for private schools in Montana are estimated to be about 96% of the average cost in public schools.
7. Individual donations to SSOs in other states appear to come primarily from private school students' relatives. This group is targeted by current fund-raising efforts by private schools. A portion of the funds donated to SSOs by individuals would represent new funds to pay for private school operations, but the rest would have gone to finance private school operations anyway, either as donations to a school or as tuition payments. Some corporate donations to SSOs would be funds that would have been donated directly to a private school, but the rest would represent new donations. Impacts were estimated with the percent of donations to SSOs that would have been made directly to a school ranging from 0% to 100%.
8. Students who would attend a private school with a scholarship from an SSO, but not without it, have families that are not willing and able to pay the current net price of a private school (full tuition less discounts less existing scholarships) but would be willing to pay the net price with an SSO scholarship. Recent research indicates that a 10% reduction in the net price of private school results in about a 2% increase in children whose families are willing and able to pay the net price to send them to a private school. (see, for example, Susan Dynarski, Jonathan Gruber and Danielle Li: *Cheaper by the Dozen: Using Sibling Discounts at Catholic Schools to Estimate the Price Elasticity of Private School Attendance*, Center for Economic Studies, U.S. Census Bureau paper CES 11-34, 2011, and Richard Blundell, Lorraine Dearden and Luke Sibiet: *The Demand for Private Schooling in England: the Impact of Price and Quality*, Institute for Fiscal Studies working paper 10/21, 2010.)
9. This bill would allow SSOs and EIOs to spend up to 10% of donations for administrative costs. States with existing credits have limits ranging from 3% to 10%. This fiscal note assumes that the average in Montana will be 5%.
10. The change in private school enrollment due to scholarships from SSOs was calculated using the following formulas describing the actions of affected private schools, families of current and potential private school students, donors, and scholarship organizations. The first is the requirement that schools set tuition to cover per-student costs less non-tuition revenue per student.

$$\text{tuition} = \frac{\text{total expenditures} - \text{nontuition revenue}}{\text{students}}$$

The second formula shows the decline in non-tuition revenue that would occur as some share of donations that formerly were made directly to a school are diverted to SSOs.

$$\text{nontuition revenue} = 2014 \text{ nontuition revenue} - \text{donations formerly made directly}$$

The third formula shows the increase in students that can be expected from any reduction in the net price of attending a private school

$$\frac{\text{additional students}}{\text{2014 students}} = -0.2 \frac{\text{change in net price}}{\text{2014 tuition}}$$

The fourth shows the change in net price for a family that receives a scholarship and donates to an SSO.

$$\text{change in net price} = \text{tuition increase} - \text{scholarship} + \text{donation} - \text{tax credit}$$

The final formula shows that scholarships are assumed to equal donations net of 5% administrative costs.

$$\text{additional scholarship support per student} = \frac{95\% (\text{corporate donations} + \text{individual donations})}{\text{students}}$$

11. By 2019, all private school students would be receiving the maximum allowable scholarship. At that point, SSOs would need to voluntarily restrict donations to remain in compliance with all the requirements of this bill. The following table shows credits, average scholarships, average discounted tuition, the average change in net price, and the change in enrollment through 2019 under two scenarios. In the first scenario, all donations to SSOs are assumed to be funds that would not be going to a private school otherwise. In the second scenario, 25% of corporate donations and all individual donations are assumed to be funds that would be going to a private school otherwise, either as tuition payments or as direct donations. The main difference between the two scenarios is that, the less new money the credit brings into the system, the higher schools have to raise tuition to capture the value of credits to subsidize additional students.

All Donations New Money					
Tax Year	Credits (\$million)	Average Scholarship	Average Tuition	Average Change in Net Price	Change in Enrollment
2015	\$5.00	\$1,344	\$6,151	(\$1,192)	270
2016	\$6.50	\$1,728	\$6,193	(\$1,534)	348
2017	\$8.45	\$2,215	\$6,245	(\$1,970)	447
2018	\$10.99	\$2,831	\$6,309	(\$2,522)	572
2019	\$12.20	\$3,120	\$6,338	(\$2,782)	631

  

No Individual Donations New Money					
75% of Corporate Donations New Money					
Tax Year	Credits (\$million)	Average Scholarship	Average Tuition	Average Change in Net Price	Change in Enrollment
2015	\$5.00	\$1,349	\$6,492	(\$1,075)	244
2016	\$6.50	\$1,732	\$6,640	(\$1,456)	330
2017	\$8.45	\$2,218	\$6,825	(\$1,942)	440
2018	\$10.99	\$2,828	\$7,057	(\$2,558)	580
2019	\$12.25	\$3,120	\$7,173	(\$2,842)	659

12. In tax years 2020 through 2023, donations and scholarships would need to remain at approximately the TY 2019 levels for SSOs to stay within the requirements of the bill.

### Technical Notes:

#### **Department of Revenue**

- Sections 9(5)(a) and 10(5)(a) increase the aggregate amount of credits allowed each year by 30% if grants or scholarships for the previous year are greater than 80% of credits claimed for the previous year. Sections 9

and 10 make individual credits equal to 50% of donations. Sections 3 and 5 require each EIO and SSO to use at least 90% of each year's contributions for grants or scholarships within three years. Thus, in general, these sections would increase the limit of credits by 30% each year when 90% of donations are greater than 80% of 50% of donations. There are only two situations in which this condition would not be met. One is if donations were more than two-and-a-half times larger than the amount needed to provide maximum individual scholarships to all students. The other is if there were a significant delay between the time donations are received and the time grants or scholarships are awarded. This fiscal note assumes that the condition will be met each year and that the credit limit will increase each year.

2. Section 6(2) reads "A parent or legal guardian of an eligible student may not accept one or more scholarship awards from a student scholarship organization if the total amount of the awards exceeds 50% of the per-pupil average of total public school expenditures calculated in [section 18]." It is not clear whether this limitation is meant to apply per student or per parent regardless of the number of students.

#### **Office of Public Instruction**

3. Section 18 of HB 511 requires the superintendent of public instruction to calculate the per-pupil average of total public school expenditures in Montana for the prior school fiscal year by August 1 of the ensuing school fiscal year. This information will not be available by August 1. The Trustees Financial Summary is due to OPI by September 15. Schools have the opportunity to amend the data until the expenditure data is finalized December 20 of each year.

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*Sponsor's Initials*

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*Date*

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*Budget Director's Initials*

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*Date*